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No. 10-749

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

RICHARD HONGSERMEIER and
FIORELLA HONGSERMEIER,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

REPLY BRIEF

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QUESTION PRESENTED FOR REVIEW

WHEN THE COMMISSIONER OF THE INTERNAL REVENUE SERVICE IS FOUND GUILTY OF COMMITTING FRAUD, MAY HE STILL, REGARDLESS, COLLECT STATUTORY INTEREST ON UNCOLLECTED FUNDS?

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ARGUMENT

INTEREST MUST STOP ACCRUING IN 1986, WHEN THE FRAUD OCCURRED.

On February 3, 2011, the Government filed its Brief for the United States in Opposition to the Petition for a Writ of Certiorari of Petitioners Richard and Fiorella Hongsermeier (Petitioners or the Hongsermeiers), arguing that this Court should not consider Petitioners' contention that the Ninth Circuit Court of Appeals erred when it decided to allow the Commissioner of Internal Revenue (the Commissioner) to collect interest on tax liabilities between December 1986 and June 1992. It argues that the fact that the Commissioner would be allowed to collect interest during the same five-and-a-half year period during which its office perpetuated a fraud on the court "raises no legal issue of continuing importance." (Opp'n, at 7.) Specifically, it urges that the Court of Appeals' decision that the Tax Court "fairly and reasonably complied with [the appellate court's] decision to 'put these taxpayers in the same position as provided for in the Thompson settlement,' 'to the extent possible and practicable,'" *Hongsermeier v. Comm'r*, 621 F.3d 890, 896 (9th Cir. 2010) (quoting *Dixon v. Comm'r*, 316 F.3d 1041, 1046 n.11 (9th Cir. 2003)), should be left alone (Opp'n, at 8). It argues that the Tax Court's finding that "[c]ancelling [Petitioners'] interest payments beyond 1986 would accord [Petitioners'] a benefit well beyond that received by Thompson," which was affirmed by the Court of Appeals, was a "fact-bound question [that] raises no legal issue of continuing importance." (*Id.*)

But the issue is not "fact-bound" or unimportant. The Government attempts to skirt the larger issue, which is of continuing importance—Government fraud—by drawing the focus to the Thompsons' tax payment history. It does so from the very first page of its Brief, where it states its own Question Presented as whether the Tax Court's error was "refusing to extinguish [P]etitioners' liability under 26 U.S.C. [§] 6601 for underpayment interest on their tax deficiencies." (*Id.* at I.) Petitioners do not seek review by this Court in order to re-litigate the issue of Petitioners' statutory liability for payment of interest; rather, the question before this Court focuses on the Commissioner's fraud.

The Court should reject the Government's Opposition to the Hongsermeiers' Petition for two reasons. First, the larger question here, of continuing legal importance, is whether the Commissioner of Internal Revenue, after he has been found guilty of committing fraud, may still, regardless, collect statutory interest on uncollected funds. As discussed in the Hongsermeiers' Petition to this Court, the fact remains that the Thompsons did not pay any interest after 1986, when the Government's lawyers exacted a fraud upon the court. The Tax Court's conclusion that interest should run between 1986 and 1992, notwithstanding the Ninth Circuit's holding that "the IRS has done little to punish the misconduct and even less to dissuade future abuse [and] the IRS should be sanctioned for this extreme misconduct," *Dixon*, 316 F.3d at 1047, was incorrect and must not be allowed to stand.

Second, it simply is *not* true, as the Government argues, and as the Ninth Circuit mistakenly accepted, that the Hongsermeiers were put in the same position as the Thompsons. While it is true "that Mr. Thompson made

an advance payment of underpayment interest in 1986" (Opp'n, at 8). This "advance payment" was made with a hot check and the "advance payment" was made during a time when personal interest was deductible, so the Thompsons were allowed to deduct interest that they did not really even pay. Further, while it is also true "that in 1987 [Thompson] paid the tax deficiencies remaining after his settlement agreement" (Opp'n, at 8), the Thompsons were allowed a 100% deduction, for reasons that were never made clear, on a highly suspicious and totally unrelated tax shelter, for which the Hongsermeiers received no reciprocal benefit. In short, the Thompsons got the benefit of a great settlement 20 years ago[1] ... plus a refund on tax interest they paid with a bounced check, in order to stop interest from accruing. The well-documented fact remains that the Thompsons paid no interest after 1986. Thus, it is dishonest for the Government to advocate the conclusion that "Mr. Thompson's advance payment of interest in 1986, combined with his full payment in 1987 of the taxes due under the Thompsons' settlement agreement, fully satisfied the Thompsons' obligations under Section 6601." (Opp'n, at 8.) To argue that the Thompsons' tax liability was satisfied, and how it was satisfied, completely ignores the fact that the settlement was procured as part of an unlawful fraud, as the United States Court of Appeals for the Ninth Circuit held.

Two trials were conducted before the Tax Court, and the IRS won both trials. The Court of Appeals for the

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1. We can never know the full extent of the deal with the Thompsons either because it was never reduced to writing or because the IRS destroyed the records during the appellate period, when fraud was being argued. (At least no written document was ever disclosed to Petitioners, even after a decade of "discovery.")

Ninth Circuit twice reversed the Tax Court Judgment. Now the Government contends that absent its fraud it would have won a trial that was permeated by fraud, and it informs this Court that the Ninth Circuit never said that the Taxpayers' shelter was a sham. Therefore, it was a sham. In fact, there are no final decisions that the tax shelters the Hongsermeiers purchased, and lost money on, were shams. This was not an issue raised on appeal. In 2002, the appellate panel in *Dixon* specifically addressed the undersigned counsel and asked what would be a fair remedy, and this counsel responded that it would be fair to give the Hongsermeiers the same deal the Thompsons received. That is what the Court of Appeals ordered, but the Hongsermeiers never got that deal. Petitioners did not know at that time that the Thompsons had other tax shelters and that they had received 100% off for those. The Hongsermeiers did not have any other shelters, so there was no reciprocal value for the Thompsons' shelters.

The Government states falsely, and hopefully by accident, that the Tax Court gave the Hongsermeiers relief for unrelated tax shelters. (Opp'n, at 5.) It is not the case that the Hongsermeiers received relief for unrelated tax shelters. The Court of Appeals said that if the Hongsermeiers had had any other shelters (which they did not) they would get relief. "Certain taxpayers, including the Hongsermeiers, did not have any additional non-Kersting-related penalties asserted against them." *Hongsermeier*, 621 F.3d at 901. The Hongsermeiers weren't among these "certain taxpayers". Thus, the Thompsons received a benefit that the Hongsermeiers did not receive. The Hongsermeiers were not even allowed to accept the 20% deal that many of the other Taxpayers took because they were told that as Test Case Petitioners, they

could not negotiate. The fraud perpetrated on them was far reaching. If the Government's position, sanctioned by the Ninth Circuit in *Hongsermeier*, that the Petitioners received the same deal or even close to the same deal that the Thompsons received, is allowed to stand, then the fraud perpetuated 20 years ago is complete. In fact, the Hongsermeiers did *not* receive even close to the same deal that the Thompsons received.

The Taxpayers never received a fair trial. The Ninth Circuit realized this fact two decades later, after many of the Petitioners were dead, the promoter was dead, and the Taxpayers would have had a difficult burden reconstructing their case. The truth is that while Kersting's deductions in unrelated cases were singularly unsuccessful, the particular shelter and situation tried more than two decades ago in the present case has never been tested in a fair trial. While lawyers can guess what would have happened in a fair trial, that trial never took place. The Court should reject the Government's assertion for the baseless conjecture that it is, that "[P]etitioners would ultimately have been required to pay substantially more in tax and interest if the Commissioner's attorneys had not engaged in the misconduct for which sanctions were imposed." (Opp'n, at 11.)

In any event, the totality of the benefits that the Thompsons received was briefed and argued before the Ninth Circuit. The Government received a victory on that issue and it was not appealed. Now the Government argues issues that the Petitioners did not raise, in an attempt to dilute the effect of the most powerful issue ... that *by the Tax Court's Order the Government received interest on money obtained through fraud.*

The Government argues that the Petitioners' Petition "reflects a misunderstanding of the relevant facts." (Opp'n, at 8.) But it is the Government that misunderstands not only the relevant facts but the applicable law of the case and the application of the law to the relevant facts. In opposition to Petitioners' assertion that the allowing the Commissioner to collect interest from 1986-1992 allows the Commissioner to profit from its fraud, the Government argues that "[b]ecause the Commissioner was required to give all tax-shelter participants the same settlement terms as the Thompsons, the United States has lost tens of millions of dollars in taxes, interest, and penalties.... " (Opp'n, at 10.) But there has been no showing that the Government "lost tens of millions of dollars" because it has not been proven that the Government was entitled to that amount. That is the point: there was no fair trial in which the tax shelters were fairly tested; the initial trial was tainted by fraud on the court; and the Government should not be allowed to benefit from that fraud, even if it was partially sanctioned for it. The fact remains that notwithstanding any settlement arrangements or partial suspension of interest, the Government will be allowed to profit from its fraud by collecting interest during the period 1986-1992, unless this Court intervenes to prevent this injustice.

CONCLUSION

For the foregoing reasons, as well as the reasons stated in Petitioners' Petition for a Writ of Certiorari, Petitioners respectfully request that the Court grant certiorari.

Respectfully submitted,

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